AMOCO PRODUCTION CO.

IBLA 2000-156 Decided September 24, 2002

Appeal from a decision of the Wyoming State Office, Bureau of Land Management, holding that an oil and gas company had improperly used reduced stripper oil well royalty rate for unit oil and gas production. WYW-109800X.

Affirmed.

1. Oil and Gas Leases: Royalties: Generally--Oil and Gas Leases: Unit and Cooperative Agreements

BLM correctly holds that an oil and gas company had improperly used the same reduced stripper oil well royalty rate for both oil and gas (and associated liquid hydrocarbon) production from a unit area, where the terms of the governing unit agreement (which controlled the governing royalty rate) did not provide for use of that reduced rate for gas production.

APPEARANCES: Rebecca S. McGee, Esq., BP Amoco Corporation, Houston, Texas, and Charles L. Kaiser, Esq., and Charles A. Breer, Esq., Davis, Graham, & Stubbs LLP, Denver, Colorado, for appellant.

OPINION BY ADMINISTRATIVE JUDGE HUGHES

Amoco Production Company (Amoco) has appealed from the January 7, 2000, decision of the Wyoming State Office, Bureau of Land Management (BLM), holding that Amoco had improperly used the reduced regulatory stripper oil well royalty rate for gas (and associated liquid hydrocarbon) production from the Light Oil Participating Area (PA) of the Salt Creek Unit Area, WYW-109800X.

This case involves the Salt Creek Unit Agreement (unit agreement), which was entered into by The Midwest Oil Company, et al., on January 10, 1939, effective September 1, 1939. 1/ At the time of Departmental approval, the unitized lands consisted of various tracts situated in

1/ The parties agreed therein to unitize 13,732.59 acres of Federal land held under various oil and gas leases, as well as State and patented lands, for the purpose of sharing the costs and benefits of oil and gas production and related activity with respect to the Unit Area, pursuant to section 17(m) of the Mineral Leasing Act, as amended (MLA), 30 U.S.C.

27 sections in Ts. 39 and 40 N., Rs. 78 and 79 W., Sixth Principal Meridian, Natrona County, Wyoming, within the Salt Creek Oil and Gas Field. Such lands were designated as part of two PA's, the "Light Oil" and the "Tensleep," which included all of the unitized lands containing oil and gas deposits in any formation above (Light Oil) or below (Tensleep) the base of the "Sundance" sand underlying those lands. (Unit Agreement, Section III at 5.) The unit agreement provided for separate allocation of production and expenses for each of the two PA's.

Effective July 19, 1977, Amoco became the unit operator, having acquired The Midwest Oil Company's majority working interest in the Unit. Amoco divested itself of its working interest in the Unit effective December 17, 1997. This case concerns only royalty payments made for unit gas production from the Light Oil PA during the period of time that Amoco was a working interest owner, that is, from July 1977 to December 1997. (Notice of Appeal at 1; Statement of Reasons for Appeal (SOR) at 7.)

In October 1992, 2/ the Department placed into effect a reduced royalty rate for stripper wells producing oil. 43 CFR 3103.4-2. Amoco used the reduced, regulatory stripper well royalty rate to determine royalty on production of oil from the Light Oil PA, in lieu of the rate set in the unit agreement.

However, BLM noted in its January 2000 decision that Amoco had also used the reduced, regulatory stripper well royalty rate to determine royalty on production of gas (and associated liquid hydrocarbons) from the Light Oil PA, instead of using the rate set in the unit agreement, in accordance with its (Amoco's) interpretation of Section X of the unit agreement. (Decision at 1). BLM disagreed with that interpretation, holding instead that the unit agreement meant to apply the same royalty rate for unit gas as unit oil production only where the rate for unit oil was determined in accordance with the unit agreement and not where it was determined "under a different authority" such as 43 CFR 3103.4-2. 3/

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fn. 1 (continued)
§ 226(m) (2000). On August 26, 1939, the Acting Secretary of the Interior approved the unit agreement.

2/ The reduced stripper oil well royalty rate appears to have been in effect beginning October 1, 1992. (Letter to Amoco from Royalty Management Program (RMP), Minerals Management Service (MMS), dated Mar. 31, 1993; Letter to Amoco from RMP dated Nov. 30, 1994.)

3/ We find BLM's explanation of the basis for its decision less than complete, leaving us to fill in many of the details. However, we do not agree with Amoco (SOR at 5-7) that BLM's January 2000 decision is completely lacking in a reasoned explanation, and thus is arbitrary and capricious.

Nor will we set aside BLM's decision because it determined only that Amoco had to pay royalty at the sliding scale royalty rate (rather than the reduced stripper oil well royalty rate) without calculating the specific royalty due or even the specific time period involved. (SOR at 7.) Since BLM did not require Amoco to recompute and pay any additional royalties due for any gas produced in the past from the Light Oil PA, we do not address the question of whether and to what extent such royalties may be due. That

(Decision at 1.) BLM specifically required Amoco to calculate royalty on unit gas production from the Light Oil PA "using the schedule set forth in Section [X] of the" unit agreement. Id. Amoco timely appealed BLM's January 2000 decision.

On appeal, Amoco admits that it has paid gas royalty at the same royalty rate paid on oil and that such rate has at times been the regulatory stripper oil well royalty rate. (Notice of Appeal at 1, 2; see SOR at 1.) It contends that this is appropriate, since the royalty rate is controlled by Section X of the unit agreement, which provision (it argues) requires that the effective rate for unit gas production be the "same percentage rate" as is "actually" being used to compute royalty on unit oil production, whether that is the sliding scale royalty rate or the regulatory stripper oil well royalty rate. (Notice of Appeal at 1-2.) Thus, Amoco concludes that, when the regulatory stripper oil well royalty rate is "actually" being used to compute royalty on unit oil production, it must also be used to compute unit gas production.

[1] This dispute is controlled by the terms of the 1939 unit agreement, which, having been approved by the United States, is a binding contract between the private parties thereto concerning, among other things, the computation of royalty owed the United States on oil and gas produced from the Salt Creek Unit. Orvin Froholm, 132 IBLA 301, 305 (1995); Chevron U.S.A. Inc., 130 IBLA 1, 3 (1994). Since the unit agreement is a private contract, the Department must give effect to the mutual intention of the parties thereto, where it is unambiguous and can be discerned from the plain language of the unit agreement.

Where necessary, the Department must also apply general rules applicable to contract interpretation to resolve any ambiguity in the unit agreement. PetroCorp, 152 IBLA 77, 84 (2000); Home-Stake Royalty Corp., 130 IBLA 36, 38-39 (1994); Colorado Open Space Council, 109 IBLA 274, 287-88 (1989); Alaska Pipeline Co., 38 IBLA 1, 15-16 (1978). This case may be resolved by construing the unit agreement as a whole, thus giving effect to all of its relevant provisions, in light of the circumstances surrounding the parties at the time of its execution. Alaska Pipeline Co., 38 IBLA at 15, citing City of Harlan, Iowa v. Duncan Parking Meter Corp., 231 F.2d 840, 841-42 (8th Cir. 1956).

Section X of the unit agreement provided the basis for computing and apportioning the Government royalty burden among the Federally-leased tracts in each of the PA's. A single royalty delivery or payment was to be made monthly to the United States, to be computed depending on (1) whether it concerned either oil production or gas production, and (2) whether such production came from either the Light Oil or the Tensleep

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fn. 3 (continued)
is a decision which must be made by MMS in the first instance. We are informed that MMS has made such a decision, and Amoco has taken an appeal (MMS-00-0059-O&G) to the Director, MMS, pursuant to 30 CFR 290.105. (SOR at 2 n.1.) A subsequent appeal may well be taken to the Board, whereupon we may address this matter.

PA. (Unit Agreement, Section X, at 20-24.) We focus on the royalty provisions applicable to the Light Oil PA, since that is what is at issue here.

Section X of the unit agreement provides: "Anything in this agreement or in any lease to the contrary notwithstanding, royalties to the United States shall be computed and delivered or paid as provided in this Section X." (Unit Agreement, Sec. X at 19.) Accordingly, we look to the royalty provisions of Section X.

Section X provides that "[r]oyalty shall be delivered or paid to the United States monthly as a single consolidated royalty account and shall be computed on the amount or value of all unitized substances produced from all land within the Participating Areas." (Unit Agreement, Sec. X at 20.) The amount of production is not at issue here; it is the royalty rate for oil and/or gas that must be determined.

The unit agreement provided that royalty for oil produced from the Light Oil PA "shall be computed" initially (during the first 3 years after the effective date of the unit agreement) at a royalty rate of 12.83 percent. Subsequently, royalty for oil from the Light Oil PA would be computed using a sliding scale royalty rate tied to the total daily average gross oil production from the Light Oil formations, throughout the Unit, during the preceding calendar month. The higher the gross production of oil from the unit, the higher the royalty rate. The royalty rate ranged from 5.0 percent for production below 3,427 bbls to 11.7 percent for production above 14,994 bbls. (Unit Agreement, Sec. X(a) at 20-21.)

The unit agreement provided also in a separate subsection that royalty for gas produced from the Light Oil PA "shall be computed each month at the same percentage rate as the effective rate of royalty on oil for said area." (Unit Agreement, Sec. X(b) at 22.)

It is thus evident that the unit agreement established separate royalty rates for oil and gas that, at least initially, were the same. Amoco argues, however, that the agreement term "same percentage rate as the effective rate of royalty on oil" applies not only to the rate expressly applicable under the unit agreement, but also to whatever rate is separately adopted by the Department by regulation for oil production, since that was the royalty that was actually being paid. We find no basis for that interpretation in the language of the unit agreement. We see nothing in the unit agreement linking the royalty rates for oil and gas forever in futuro. 4/

It remains to determine whether the unit agreement can be seen as authorizing a lower royalty rate for oil production than for gas

4/ We note that, if Amoco is correct that the royalty rates for oil and gas were to be permanently linked, it would be reasonable to conclude that it could not have properly availed itself of the reduced royalty rate for oil.

production. We conclude that it can. Section X(aa) 5/ of the unit agreement acknowledged the possibility of future revisions in the royalty rates for oil and for gas:

> The rates of Government royalty herein specified are predicated on a forecast of future conditions and are intended to return to the United States the same average annual rates of royalty from the unit area as would be realized in the absence of this agreement. If said rates are found to be unfair or unreasonable or fail to accomplish with reasonable approximation the intent herein expressed, on agreement by the Secretary of the Interior and the Operator, they may be revised as to future production. Nothing herein contained shall be deemed to deprive the Secretary of the Interior of any authority which he has under existing law or may have under amendments thereof to reduce the rate of royalty on future production from the unit area for the purpose of encouraging the greatest ultimate recovery of oil or of conserving the oil and gas resources of said area.

Id. at 24. Accordingly, under this section, the Department retained its authority to reduce (but not to increase) the royalty rates specified in the unit agreement on future production (1) either if the rates are found to be unfair or unreasonable, or if the rates fail to return to the United States the same average annual rates of royalty from the unit area as would be realized in the absence of this agreement; and (2) the operator and the United States both agree to the revision. Further, the parties expressly agreed that the Department retained its authority to unilaterally reduce the rate of royalty on future production from the unit area for the purpose of encouraging the greatest ultimate recovery of oil or of conserving the oil and gas resources of said area.

Applying those provisions to the circumstances presented in this case, the result is the same, viz., that the royalty rate for oil has been revised (reduced), but the royalty rate for gas has not. Pursuant to its current discretionary authority under section 39 of the MLA, in promulgating 43 CFR 3103.4-2, the Department determined in 1992 that it would reduce the royalty rate for oil in order to encourage the continued production of oil from so-called "stripper wells," that is, wells that are uneconomic or marginally economic. See 57 FR 8605-06 (Mar. 11, 1992). However, the Department made it clear that "the royalty rate reduction is only applicable to oil production." 57 FR 35968-69 (Aug. 11, 1992); State of Wyoming, 117 IBLA 316, 321-23 (1991), aff'd, State of Wyoming v. Lujan, No. 91-CV-0097-B (D. Wyo. Dec. 16, 1991); Sol. Op. M-36920 ("Reduction of

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5/ Section X of the unit agreement contains separate subsections at pages 24 and 25 applying to "Government Royalties from either or both Participating Areas" designated (a) through (c). However, the subsections at pages 19 through 24 are also designated as (a) through (f). To distinguish the two, we shall refer to the subsections at pages 24 and 25 by double letters. Thus, Section X(a) on page 24 is referred to as Section X(aa).

Production Royalties Below Statutory Minimum Rates"), 87 I.D. 69, 78-79 (1979). Since the Department thus expressly sought to "encourag[e] the greatest ultimate recovery of oil," 6/ as envisioned in Section X(aa) of the unit agreement, that provision superseded the unit agreement provisions establishing the royalty rate for oil.

Whether viewed as a reduction intended to cure a royalty rate for oil that was "found to be unfair or unreasonable" (with such reduction agreed to by both the United States, by establishing a lower rate for oil, and by the operator, by paying at the lower rate) or as a unilateral action taken "for the purpose of encouraging the greatest ultimate recovery of oil or of conserving the oil and gas resources of said area" (which purpose is precisely what the stripper oil well reduction was intended to cover), it is evident that the reduction in the oil rate was expressly authorized by Section X of the unit agreement.

However, we can draw no similar conclusion concerning gas. We find no evidence of the circumstances pertaining to gas produced from the well and, therefore, have no basis for concluding that the parties agreed to lower the royalty rate applicable to gas produced under the unit agreement. Indeed, by demanding that royalty be paid based on the unit agreement, the Department plainly signals that it does not agree to a reduction in the unit agreement royalty rate for gas. Nor can the Department be seen as having unilaterally lowered the royalty rate for gas. Indeed, in promulgating the stripper well royalty rate reduction regulation, BLM specifically stated that it did not apply to "stripper gas wells." 57 FR at 35968. Clearly, the Department did not determine that there should be a corresponding reduction in the royalty rate applicable to gas produced from the same wells. BLM expressly notified the lessees that no reduced rate had been put in place for gas or related liquid products. See Letter to Amoco from RMP, MMS, dated Nov. 30, 1994, at 1 ("As operator of a stripper oil [well] property, you are responsible for notifying all parties who report and pay royalties to MMS that the lease royalty rate for oil has been reduced. The reduced royalty rate does not apply to condensate, gas, or gas plant products."). Rather, 43 CFR 3103.4-2(b)(7) specifically directed that there be a separate calculation, using the "lease royalty rate" for gas produced from stripper oil wells. (Emphasis added.) The lease royalty rate, in the present case, was the sliding scale rate under the 1939 unit agreement, which (unlike the rate for oil) has never been revised. 7/

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6/ The Department employed the same terminology as that adopted in the unit agreement: "A royalty rate reduction for stripper oil [well] properties is warranted in order to encourage the greatest ultimate recovery of oil from those properties." 57 FR at 35969.

7/ Our construction is not at odds with the terms of Section II of the unit agreement, which states that all future regulations implementing the MLA "are accepted and made a part of the" agreement, except that "no regulations inconsistent with the specific terms of the leases or this agreement, particularly in the matter of rates of royalty * * * are hereby accepted." Since the Department's action in reducing the royalty rate for

The fact that the unit agreement acknowledged the Secretary's retained authority to reduce one or more of the royalty rates established in the unit agreement meant that the Secretary's action to reduce one applicable rate left intact the other original royalty rate that applied to gas. There is no doubt that the Secretary's action was intended, as a general matter, to affect only applicable royalty rates for oil. We therefore conclude that BLM correctly held that Amoco had improperly used the reduced stripper oil well royalty rate applicable to oil production from the Light Oil PA to compute the royalty owed for the production of gas (and associated liquid hydrocarbons) from that PA.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

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David L. Hughes
Administrative Judge

I concur:

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T. Britt Price
Administrative Judge

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fn. 7 (continued)
stripper oil and not gas was consistent with the royalty provisions of Section X(aa), the reduction could properly be "accepted and made a part of the" agreement under Section II.

Moreover, our construction is consistent with Section XV of the unit agreement, which states that the parties consented to the conformance of the royalty provisions of the leases with the requirements of their unit agreement.

Although Amoco argues that Section X(b) should be interpreted as requiring the computation of the gas royalty rate based on the reduced stripper oil royalty rate, it has addressed neither the specifics of the other relevant unit agreement terms on which we rely, nor whether, taken together, they can reasonably sustain Amoco's interpretation.